

This letter reviews the taxability of "incentive credits" under the Telecommunications Excise Tax Act. (This is a PLR).

August 13, 2001

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see enclosed), is in response to your letter of June 25, 2001. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

COMPANY requests a Private Letter Ruling, pursuant to 2 Ill. Admin. Code §1200.120.

We call your attention to the Department of Revenue's letter of July 26, 2000, which was a General Information Letter, dealing with this request. We request reconsideration of that letter's conclusions. We understand that conversations with a representative of a consultant to the Company subsequent to the July 26, 2000 letter have indicated the Department's willingness to review that letter in light of the Illinois Supreme Court's ruling in Saxon Western Corp. v. Mahin, 81 Ill. 2d 559, 411 N.E.2d 242 (1980).

We further suggest that reconsideration is appropriate because the Company is the taxpayer under the Illinois Telecommunications Excise Tax Act ('Act'). The Department's July 26, 2000 letter declined to issue a private letter ruling because the telecommunications carrier involved had not submitted the letter. The Act defines the taxpayer as 'a person who individually or through his agents, employees or permittees, engages in the act or privilege of originating or receiving telecommunication in this State and who incurs a liability under this Article.' 35 ILCS 630/2(h). Since it is the Company that bears the legal incidence of the tax, this request is a 'specific taxpayer inquiry concerning the application of a tax statute or rule to a particular fact situation.' 86 Ill. Admin. Code §1200.110. A private letter ruling would thus appear to be appropriate.

The Company is not the subject of an audit by the Department, nor is this issue the subject of litigation. We are unaware of any authority to the contrary of that set forth in this letter.

**I. Facts.**

The Company has a contract with a telecommunications carrier for the provision of long distance telecommunications services in which it has committed to use the carrier's

services at a certain volume level for a period of three years. The carrier in turn committed to deliver services at certain favorable rates for the same period. The rates are standard tariff rates that are discounted proportionate to the volume and term agreed to by the Company.

A copy of the contract is enclosed.

In addition to the monthly discounts, the contract also provides for certain discount credits to be applied at specified periods of time. The first of the discount credits is referred to as a 'conversion credit.'<sup>1</sup> The conversion credit was given to the Company in the third month of the contract, in the form of a credit memo mailed separately from the bill. The carrier instructed the Company to subtract the credit amount from its payment on that month's bill.

The second type of credit is a negative dollar amount that appeared on bills sent to the Company in subsequent months. These credits appeared directly on the bills sent to the Company by the carrier and were not separately issued credit memos. The credits appeared on the bills below the tax line as a negative dollar value. Their effect was to reduce the current amount due for that month.

The carrier computed the Illinois Telecommunication Excise Tax ('Tax') based on discounted service and usage charges provided for in the contract. However, the tax base was not reduced to reflect either the credit memo or the credits that appeared on the bills as negative numbers. The Illinois Telecommunication Excise Tax was applied on pre-credit charges.

The following illustration will serve to clarify the carrier's application of Tax with respect to Credits:

Minutes used times tariff rates =	\$100.00
Less, discounts	<u>(30.00)</u>
Equals	\$ 70.00
Tax rate	<u>7%</u>
Tax	\$ <u>4.90</u>
Subtotal	\$ 74.90
Less, CREDIT	<u>(50.00)</u>
Amount due and payable	\$ <u>24.90</u>

The Company believes that the carrier overcharged Tax with respect to the discount credits and that a tax refund is due. The following illustration shows the Company's position with respect to how the credit should be treated in the computation of tax:

Minutes used times tariff rates =	\$100.00
Less, discounts	(30.00)
Less, credit	<u>(50.00)</u>
Equals	\$ 20.00
Tax rate	<u>7%</u>
Tax	\$ <u>1.40</u>
Amount due and payable	\$ <u>21.40</u>

In both cases, the credits are factored into the calculation of gross charges. The only distinction between the two scenarios is whether the credits serve to decrease the amount subject to Tax.

The Company has filed a refund claim with the carrier. The carrier declined to refund the taxes paid.

## **II. Taxation of credits under the Telecommunications Excise Tax Act should follow the taxation of discounts under the Retailer's Occupation Tax Act.**

The treatment of discounts and credits under the Telecommunications Excise Tax and under the Retailers' Occupation Tax ('ROT') should be identical because the two statutes use language that is virtually identical to describe the tax base. Because the Illinois Supreme Court has specifically considered the impact of discounts and credits under the Retailers' Occupation Tax, that precedent should be controlling for interpretation of the Telecommunications Excise Tax.

The Telecommunications Excise Tax falls on the 'gross charges' made by the telecommunications retailer. The statute defines 'gross charges' as:

'Gross charge' means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer, valued in money whether paid in money or otherwise, including cash, credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of materials used, labor or service costs or any other expense whatsoever.

35 ILCS 630/2.

The Retailers' Occupation Tax is imposed on the retailer's 'gross receipts.' That term is defined as the 'total selling price.' The latter term is in turn defined as:

the consideration for a sale valued in money whether received in money or otherwise, including cash, credits, property other than as herein provided, and services....

35 ILCS 120/1.

For purposes of consideration of the impact of a discount, the two statutes are identical. Each defines the tax base as the amount of consideration for the transaction 'valued in money whether [paid -ROT] [received - TET] in money or otherwise, including cash, credits, services and property of every kind or nature,...' The precedents under the ROT governing the treatment of discounts should be controlling in considering the impact of credits or discounts under the Telecommunications Excise Tax.

The key decision dealing with discounts is Saxon-Western Corporation v. Mahin, 78 Ill. App. 3d 125, 396 N.E. 2d 1195 (1st Dist. 1979) affirmed 81 Ill. 2d 559, 411 N.E. 2d 242 (1980). In Saxon-Western, the court dealt with the treatment of discount coupons issued by a retailer to the general public through newspaper advertising and mailing circulars.

The retailer issued the coupons itself and did not receive reimbursement from a third party when the customer presented the coupons at the time of the transaction. The Department of Revenue asserted that the retailer's gross receipts included the cash paid by the customer plus the value assigned to the coupon. The Department of Revenue claimed that the coupon's value was part of the gross receipts because it constituted part of 'the consideration for a sale valued in money, whether received in money or otherwise. ...'

Both the Illinois Appellate Court and the Illinois Supreme Court found that the coupons were not gross receipts and thus were not part of the tax base. The Appellate Court determined that the non-reimbursed coupons were not part of the retailer's gross receipts. The Appellate Court agreed with the retailer's contention that 'its coupons simply constitute an alternate way of giving its customers cash discounts.' The Illinois Supreme Court affirmed the Appellate Court's decision. The Supreme Court stated:

...the plaintiff herein shall not be made to pay a tax on an amount in excess of his gross receipts. In short, where a retailer has foregone realizing cash receipts in the hope of increasing the volume of his business and also in the hope of learning the most effective means of advertising, no taxable event occurs. This result is supported by the concession made by the Department during oral argument that if the plaintiff had just placed items on sale and had not distributed coupons, a tax would be measured by the sale price, not the regular retail price. We perceive no difference between the two situations.

The Telecommunications Excise Tax Act's adoption of the Retailers' Occupation Tax Act's language that establishes the tax base requires that the credits issued by the carrier be excluded from the tax base. Each credit represents a deduction in the amount that changed hands between the retailer and its customer as part of a transaction. In Saxon-Western, the Supreme Court viewed the coupon as being indistinguishable from the situation in which the retailer simply placed the product on sale. The retailer elected to accept less consideration from the customer in exchange for the product.

The analysis under the Telecommunications Excise Tax is identical with respect to both forms of credits that the carrier issued to the Company. The carrier determined that it would sell telecommunications service for less money than called for by the tariff. It did so to obtain the Company's business and as an incentive for the Company to increase its usage of the service.

There are no language differences between the ROT and the Telecommunication Excise Act that lead to a different result. The Telecommunications Excise Tax defines 'gross charges' as 'the amount paid for the act or privilege of originating or receiving telecommunications...' 35 ILCS 630/2(a). The Act further defines the 'amount paid' as 'the amount charged to a taxpayer's service address.' 35 ILCS 630/2(b).

The Telecommunications Excise Tax Act's reference to 'amount paid' and 'amount charged' are complementary. The words 'amount paid' establish the amount of consideration by which the tax is measured. The amount paid is the amount that the customer transfers to the retailer. The definition of 'amount charged' as 'the amount charged to the taxpayers' service address in the State regardless of where such amount

is billed or paid' establishes that the tax falls on telecommunications that originate or are received in Illinois.

**III. The 'credit' to which the Telecommunication Excise Tax Act refers is the consideration that flows from a customer to the telecommunications retailer and not to the discount given to the customer by the retailer.**

The Telecommunications Excise Tax Act's reference to 'credit' is meaningful and the treatment sought for the conversion credit and the incentive credits is consistent with the statute. It does not require that any statutory language be disregarded.

One example of a 'credit' that would be taxable is an instance in which a customer has overpaid the carrier. For example, assume that the current month's gross charges are \$75 and that the customer pays \$100. The amount of overpayment, \$25, is considered a credit that will be applied to the following month's bill. However, the fact of overpayment does not change the amount of money billed for either of the months nor the total amount of money expected to be received by the carrier. The carrier has simply received a portion of the amount in advance.

Another scenario in which the word 'credit' as used in the Act would apply is when the carrier itself extends credit to the customer. In such a scenario, the carrier and the customer have made arrangements for the customer to pay incrementally on the amount billed. Although the customer does not pay the full amount billed by the carrier at one time, the carrier still has an expectation of receiving over time the full amounts billed. Therefore, the full amount charged is subject to Tax under the Act as the carrier will receive the full amount charged.

Another example is a situation in which the customer might furnish the carrier consideration in lieu of cash for the receipt of services, such as in a bartering situation. In this context, the term 'credit' addresses the possible payment arrangements ('cash, credits, services and property of any kind') that could be fashioned to satisfy a customer's financial obligation to its telecommunications carrier. For example, in the event that a reciprocal business relationship exists between the carrier and the customer, the customer may want to issue a credit of its own to the carrier. It seems clear that this provision was incorporated into the Act so that bartering arrangements and the like would not serve to reduce gross charges below the true value, in money, of the telecommunications services.

In each of the above instances, the carrier expects to receive and is entitled to receive the full amount billed either in cash or in a corresponding value of credit, services, or property if in a bartering arrangement. Credits in the above contexts do not affect the gross charges, amount billed, or amount to be paid as the carrier does expect to receive the full fair market value of its services. The dollars represented by these credits are properly subject to Tax.

In contrast to these situations, the credits in question with the carrier were not issued in exchange for goods or services provided by the Company to the carrier. The credits were not purchased, traded for, or earned like barter currency stemming from a separate transaction. They have no monetary value of their own apart from this sale of telecommunications service.

We ask that you confirm that the credits described herein are not part of the gross charges subject to tax. We also ask you to confirm that, upon filing a proper and timely claim, the carrier will be entitled to a refund of the Tax remitted with respect to the credits.

Please call me if you have any questions or need additional information. Thank you for considering our request for a Private Letter Ruling.

We have reviewed your presentation of the issue, along with the contract and the Saxon-Western case. We agree that the conversion credits and recurring credits described, despite the nomenclature, are discounts for which the retailer receives no receipts. They are therefore not credits required to be included in the 'gross charges' subject to Telecommunications Excise Tax Act. If the carrier wishes to file a timely claim for credit based upon this ruling, it may do so, although this Private Letter Ruling is binding only as to COMPANY.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk

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<sup>1</sup> The term 'conversion credit' is used in acknowledgement of the fact that it generally takes a large, multi-location customer several months to make the switch from one carrier to another. This can be costly to a customer, since on the date that the contractual commitment to the old carrier ends, the rates automatically revert back to standard tariff rates, without discounts. A significant expense is incurred in the months it takes a customer to achieve a full cutover to the new carrier. A conversion credit may be given by the new carrier to lessen the budget impact of that additional expense.